January, 2001

Report to the Civil Division of the Wayne County Circuit Court

by the

Committee on Attorney Fees on Structured Settlements

Hon. William J. Giovan, Chair
Wayne County Circuit Court
Hon. Pamela R. Harwood
Wayne County Circuit Court
Hon. David J. Szymanski
Wayne County Probate Court

Background

The subject of our inquiry was brought to the attention of the Civil Division at its meeting of July 17, 2000. On that occasion, Judge Szymanski noted that there is an ambiguity in the process of calculating and approving attorney fees where settlements for injured parties, particularly minors and other persons under a disability, are accomplished by the use of a structured settlement.[1] After considerable discussion by those present, the Hon. Paul Teranes, Chief of the Civil Division, later appointed the undersigned as a committee to study the problem and make recommendations to the Division. As a result of our investigations, the Committee makes the recommendations noted at the conclusion of this report.

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[1] Circuit Court judges have the obligation to approve settlements, costs and attorney fees on the record for minors, legally incapacitated persons and estates in wrongful death cases. MCR 2.420 and MCL 600.2922. Probate judges have the obligation to pass on the sufficiency of bonds. MCR 2.420. However, a new court rule, Interim MCR 5.206, requires prior approval of the probate court if a fiduciary is entering into a settlement that creates a trust or involves payments to be made more than one year from the date of the settlement. Therefore, probate judges have the obligation to review structured settlements and trusts prior to circuit court approval.

The Problem

The problem involves the manner in which attorney fees on structured settlements are to be calculated. MCR 8.121(C), which addresses contingent fee agreements, says that "[i]n the case of a settlement payable in installments, the amount referred to in subrule (B)[the maximum allowable fee] shall be computed using the present value of the future payments." In ordinary parlance, and presumably in the court rule as well, the term "present value" is intended to refer to a specific dollar amount which, invested at present, will fund a defined stream of payments to be made in the future. At the bench meeting, it was the consensus of the judges that representations as to "present value" at hearings to approve settlements have historically meant the disclosure of the actual cost that the defendant was paying to purchase the annuity. What has been learned is that:

1. in this non-adversarial proceeding, no attorney has the duty to disclose the actual cost; and,

2. in the event the court adopts a value other than actual cost, the calculation of "present value" is not susceptible to standardization. Among the factors that affect the present value, of course, are the applicable interest and discount rates, and the period over which the payments are to be made. When the period over which the future payments are made is defined by the life expectancy of the injured party, an additional uncertainty is introduced, one which must be resolved by an attempt to calculate the life expectancy in any given case, and,

3. calculating the attorney fee on a number greater than actual cost is done without full disclosure to plaintiff who is relying on plaintiff's counsel with whom there is a conflict of interest. The settlement is placed on the record with the judge expected to insure that the proceeding is fair and in accordance with the applicable statutes and court rules. However, when the actual cost has not been disclosed to the judge, it is impossible for the judge to fulfill this function.

The court rule does not define "present value." The problem for a judge called upon to approve a structured settlement and the attorney fee related to it, as we have come to learn, is that there have been differing methods of calculating present value, which, of course, produce different results. The differing results, in turn, present a problem for the court; first, in determining whether the settlement should be approved (when the approval of the court is required) and, second,

determining the correct fee under the court rule.

One method for determining present value is the "actual cost" method. In any given structured settlement, the institution that issues the annuity will make its own calculations of the cost of the annuity, based in part on its individualized calculation of the life expectancy of the injured party (the "rated age"), and will charge the defendant or its insurer the dollar amount of the cost. That dollar amount is represented to the court as the present value of the future payments, and the plaintiff's attorney calculates the attorney fee on that amount. The Committee's investigation discloses that this method of determining "present value" is nearly universal.

Another method of calculating present value is employed by a small minority of attorneys. In that method, the attorney either ignores or makes no attempt to determine the actual cost of the structured settlement. Instead, the attorney obtains an opinion of the "present value" from a broker or other source that is based upon the life expectancy calculated for example, by the medical expert that the attorney intended to use in testimony at trial. That expert, of course, will have tended to be optimistic about the plaintiff's life expectancy, and the present value determined in that fashion, and the attorney fee as well, will be greater than one arrived at by using a more realistic life expectancy.

The consequences to the often unknowing injured party is significant. For example, one recent case reported by Judge Szymanski involved the plaintiff's attorney representing to the circuit court judge that the present value of the annuity was $1,067,952 when the actual cost of the annuity was $551,526. This representation increased the one-third attorney fee from $480,848.76 to $651,832 which was taken from the up front cash.[2]

[2] The judge had appropriately appointed a guardian ad litem for the minor in this case because of the request by the next friend mother for an allocation to her of $100,000. The court appointed a GAL recommended by plaintiff's counsel who accepted the figures provided by plaintiff's counsel even though the suggested "present value" exceeded the sum total of guaranteed future payments. The court replaced this GAL with one who discovered the actual cost of the annuity and learned that the injured minor did not even live with the mother who was seeking $100,000 for her attendant care of the minor. This case illustrates the importance of appointing trained and independent GALs who can objectively review the costs and proposed distribution as well as ascertain the actual cost of the annuity prior to the hearing.

The Committee Deliberations

The Committee met on August 16 and August 30 to discuss issues and share information obtained individually from various sources. On October 25, the Committee met with the following individuals for a plenary discussion of the issues:

Carole L. Chiamp, Attorney at Law, guardian ad litem.

Richard C. Kaufman, former Circuit Judge, Attorney at Law and mediator.

Paul L.B. McKenney, Tax Attorney, author on structured settlements.

Gregory Pollix, broker for structured settlements.

Paul Allen Rosen, plaintiff's attorney.

John E.S. Scott, defense attorney.

Much of the meeting was spent in discussing with the Committee the actual practice regarding structured settlements. The discussion confirmed the Committee's impression that the vast majority of plaintiff attorneys use actual cost in representing the value of the settlement to a court and as a basis on which to determine attorney fees. All present agreed that the fairest and most expeditious method of determining the present value of a structured settlement and the appropriate attorney fee is the "actual cost" method.

Using the "actual cost method" would effect several changes in the present practice:

1. In some instances, the defense attorney will not have made any attempt to ascertain the present value of a settlement and will be unable and/or unwilling to make a representation of present value to the court. A practice or rule that requires that the court be apprised of actual cost will likely place an obligation on defense counsel to ascertain and disclose that actual cost.

2. Resistance to the disclosure of actual cost has been based on the mistaken belief that knowledge of the cost of the settlement by the plaintiff amounts to constructive receipt of the amount and that interest earned by the annuity becomes taxable to the recipient. Attached to this report is a series of articles by Reed & Stratford, Inc., one of which explains that the same is not true:

> Discussing the amount the defendant will spend on the structured settlement will not cause the plaintiff to be in constructive receipt of that amount. Priv. Ltr. Rul. 83-33-035 (May 16, 1983) ("disclosure by defendant of the existence, cost or present value of the annuity will not cause you to be in constructive receipt of the present value of the amount invested in the annuity"); Priv. Ltr. Rul. 90-17-011(Jan. 24, 1990)("knowledge of the existence, cost and present value of the annuity contract used to fund the settlement offer...will not cause the family to be in constructive receipt of the amount payable under the annuity contract or the amount invested in the annuity contract").

3. Opposition to the disclosure of actual cost may come from the defendant or defendant's insurer who is purchasing the annuity. This is often because a defendant who places many annuities during a year may expect a rebate from either the agent it used by a return on part of the commissions it paid or from the company who issued numerous annuities for the defendant. Any subsequent refund or rebate would lower the actual cost of the annuity. It is the Committee's understanding that such a procedure is illegal, and we attach to this report a copy of a letter written by one Kevin Mack that discusses the legality of such arrangements. Illegal or not, a rebate given to the issuer reduces the net cost of the annuity, and, to the extent that the rebate is hidden, the true cost of the structured settlement is not accurately represented. Another method of saving costs, though with no illegality involved, is that certain agents who do a high volume of purchases of structured settlements will be able to negotiate a "volume discount" with the issuer of the annuity, the benefit of the discount being passed along to the defendant or its insurer that pays for the structured settlement.

The procedure recommended by the Committee does not tolerate hidden rebates or discounts, the guiding principle being that an accurate evaluation of a structured settlement, and the consequent attorney fee, requires full knowledge of circumstances by all persons involved in the process. We believe that the integrity of the judicial process demands nothing less.

It has been suggested that insurance companies will not be motivated to use structured settlements if they are prevented by a full disclosure process from receiving a discount. On the contrary, the Committee believes that the tax and other benefits of structured settlements will continue to be attractive to plaintiffs, and therefore to defendants who wish to use that incentive to

settle their potential liabilities. Any savings that would otherwise be the subject of a rebate or discount will be accounted for by the negotiation process between plaintiff and defendant.

There is no present dollar amount paid, of course, in those smaller number of instances where a structured settlement is funded by a self-insured defendant. In those cases there is genuine question of ascertaining the present value of the stream of payments. In those instances the Committee recommends that the court should appoint an independent person with experience in such matters, such as, say, an agent who is in the business of placing annuities, who would ascertain what would be the cost of obtaining an annuity from an institution of financial standing similar to that of the self-insured defendant. It is crucial that the court not appoint experts suggested by either party.

The Recommendations

1. The Committee recommends that, in evaluating structured settlements and approving attorney fees thereon, the judges of the Third Circuit should interpret the term "present value," as used in MCR 8.121(C), to mean the actual cost paid by the defendant or its insurer to fund the structured settlement. This obviously requires that the actual cost of the annuity incurred by the defendant be disclosed in open court. To facilitate hearings on such matters, we recommend that the court require the use of an instrument that certifies such cost, a specimen entitled "Certification of Structured Settlement" being attached to this report. However, until the production of this certificate is standard practice, the Committee recommends that the disclosure be in accordance with evidentiary rules. In other words, affidavits, letters to the defendant indicating the amount it is being charged, or other written statements admissible as a business record are adequate even if merely referenced on the record but not admitted as part of the record for reasons of confidentiality. Estimates or "understandings" of counsel are not adequate.

2. In the event of a structured settlement funded by a self-insured defendant, the Committee recommends that the court determine "present value" by ascertaining from the certification or testimony of an independent person with knowledge what would be the actual cost of a structured

settlement if paid for by an institution with similar financial standing to that of the self-insured defendant.

3. Considering that the issue under discussion is relevant state-wide and not merely in Wayne County, the Committee suggests that the judges of the Third Circuit recommend to the Supreme Court that MCR 8.121(C) be amended as follows:

> (C) Computation. The amount referred to in subrule (B) shall be computed on the net sum recovered after deducting from the amount recovered all disbursements properly chargeable to the enforcement of the claim or prosecution of the action. In computing the fee, the costs as taxed and any interest included in or upon the amount of a judgment shall be deemed part of the amount recovered. In the case of a settlement payable in installments, the amount referred to in subrule (B) shall be computed using the present value of the future payments. PRESENT VALUE SHALL BE DETERMINED BY THE ACTUAL COST TO THE DEFENDANT OF FUNDING THE FUTURE PAYMENTS. IN THE EVENT THAT FUTURE PAYMENTS ARE TO BE MADE BY A SELF-INSURED DEFENDANT, PRESENT VALUE SHALL BE DETERMINED BY ASCERTAINING WHAT WOULD BE THE ACTUAL COST OF FUNDING THE FUTURE PAYMENTS TO AN INSTITUTION OF FINANCIAL STANDING SIMILAR TO THAT OF THE DEFENDANT.

For those interested in learning more about structured settlements, the Committee recommends reference to an article attached hereto entitled, "Structured Settlements." Also, copies of the briefs submitted on the legal issues mentioned above are available from the Committee.

Respectfully submitted,

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Wayne County Circuit Court

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